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Sustaining Growth in Developing Economies through Improved Taxpayer Compliance: Challenges for Policy Makers and Revenue Authorities

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Abstract
The existing body of literature on taxpayer compliance has developed over some 30 years or more and has predominantly emanated from developed economies. However, policy makers and revenue authorities in developing economies face quite different challenges and constraints. These include limited administrative resources and expertise, weak tax administration, widespread evasion, corruption and coercion, low taxpayer literacy and morale, and negative attitudes towards government. This article explores these challenges and constraints in developing economies. It identifies strategies to improve taxpayer compliance and the necessary steps to implement them in order to achieve sustainable economic growth.

1. INTRODUCTION

Taxes, and tax systems, are fundamental components of any attempts to build nations, and this is particularly the case in developing or transitional nations. As Brautigam has noted, "[t]axes underwrite the capacity of states to carry out their goals; they form one of the central arenas for the conduct of state-society relations, and they shape the balance between accumulation and redistribution that gives states their social character".[2] In short, taxes build capacity (to provide sem.12Fstate]TJ1p2 408.92de extensive evasion, corruption and coercion. In many cases overall tax levels are low, and large sectors of the informal economy escape the tax net entirely”.[4]

maintaining all records as required.[6]

A non-compliant taxpayer is one who fails to satisfy any one or more of these aspects and poses a risk to revenue collection. Research has shown that non-compliance may be as a result of a deliberate decision by the taxpayer, or it may be unintentional.[7] Further, there is a range of possible compliance outcomes driven by a variety of factors including demographic (including age, gender and level of education), personal (including attitudes, experiences, morale and financial circumstances) and aspects of the tax system itself (including tax rates, penalties, audit probabilities, enforcement strategies, complexity and costs of compliance). As many of these factors are not constant, it is to be expected that compliance behaviour can change over time and a compliant taxpayer one year may be non-compliant the next.

From the perspective of the revenue authority, the ideal is to have all taxpayers fully compliant at all times. If this were the case, the tax gap (the difference between what a revenue authority theoretically should collect and what it actually does collect) would not exist. The ideal is obviously not attainable. But to be able to work towards this ideal, the revenue authority needs to be able to identify and understand the various types of compliance outcomes and then develop and apply appropriate strategies to modify (or reinforce) taxpayers' behaviour accordingly. As the revenue authority normally has limited resources at its disposal, it needs to be strategic if it is to be efficient and effective in managing its risks. This will require the authority to identify and prioritise its risks, to tailor and target specific activities to each identified risk, and to allocate resources accordingly. This is commonly referred to as a risk management approach to compliance and is widely adopted in many jurisdictions, and in particular, where taxpayers are required to self-assess their tax liability.[8]

The 2004 OECD report notes that "the benefits of pursuing a risk management approach are well established. For a revenue authority they include:

a structured basis for strategic planning;

a focus on the underlying drivers (not symptoms) of non-compliance, and promotion of diversity in the treatment of major tax compliance risks, rather than the adoption of a 'one size fits all' approach;

better outcomes in terms of programme efficiency and effectiveness (e.g. improved compliance with tax laws leading to increased tax collections and improved taxpayer service);

a defensible approach that can withstand external scrutiny (e.g. by external audit officials); and

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[6] Roth, J., Scholz, J. and A. Witte (Eds) 1989, *Taxpayer Compliance Volume 1: An Agenda for Research*, University of Pennsylvania Press, Philadelphia, p. 21.

[7] McKerchar, M., 2003, *The Impact of Complexity Upon Tax Compliance: A Study of Australian Personal Taxpayers*, Research Study No. 39, ATRF, Sydney.

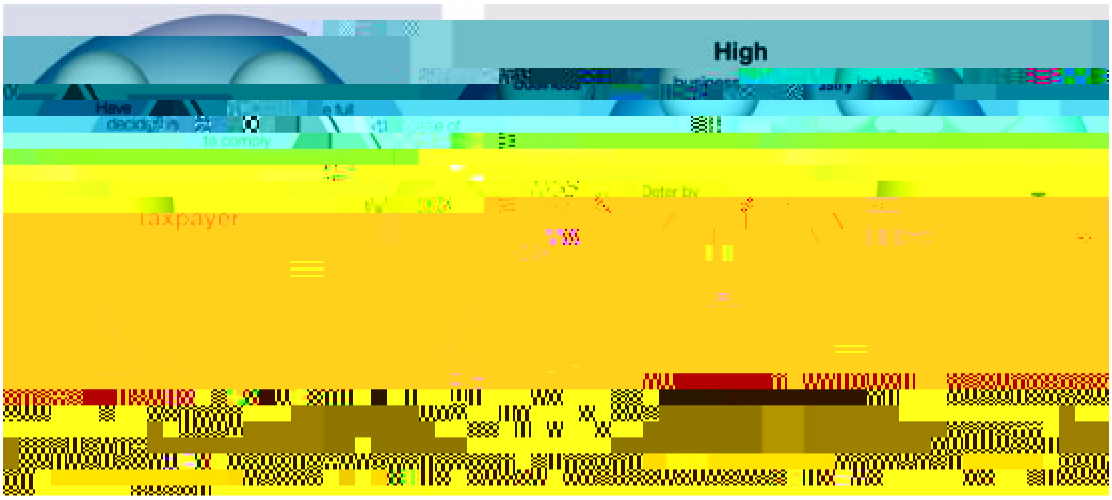
[8] For example, the Australian Taxation Office, the New Zealand Inland Revenue Department and the OECD have adopted compliance models which are based on a risk management approach and this approach is endorsed by the OECD. See OECD, 2004, *Compliance Risk Management: Managing and Improving Tax Complianc*

a stronger foundation for evidence-based evaluation."[9]

The Australian compliance model (see Figure 1)[10] is typical of the models currently being operated by revenue authorities in many developed countries. The models are based on the premise that the revenue authority can influence behaviour through its responses and interventions. The focus is upon the causes rather than the symptoms of non-compliance, requiring an understanding of the business, industry, sociological, economic and psychological factors that drive taxpayer behaviour.

The model's core principle is to make compliance (including access to entitlements and benefits) as easy as possible for those who want to comply. At the other end of the spectrum, the full force of the law is applied when taxpayers willfully seek to abuse the system.

FIGURE 1: THE AUSTRALIAN TAXATION OFFICE COMPLIANCE MODEL



The underlying assumption in the risk management approach is that all risks can be identified and measured to some extent. The reality is likely to be quite different. The discussion that follows serves to illustrate that there are many dimensions to compliance behaviour and that it is a complex and multi-dimensional problem. A standard solution to the problem has thus far proved to be elusive and it continues to pose a formidable challenge to tax administrators globally.[11]

[9] OECD, note 8 at p. 8.

[10] Australian Taxation Office, *Compliance Program 2008-09*, Commonwealth of Australia, Canberra, available at http://www.ato.gov.au/corporate/content.asp?doc=/content/00155156.htm&page=12&H12 accessed 29 August 2008.

[11] Brooks, N., 2001, 'Key Issues in Income Tax: Challenges of Tax Administration and Compliance', paper presented at Asian Development Bank 2001Tax Conference, 8 September 2001, p.6; and more generally, Freedman, J. (Ed.), 2008, *Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management*, Oxford University Centre for Business Taxation, Oxford.

2.2 Understanding compliance behaviour

Over the last thirty years or so, a considerable body of literature has developed in the area of taxpayer compliance from which has emerged two significant and widely accepted findings. Firstly, taxpayer non-compliance is a continual and growing global problem that is not readily addressed. Secondly, despite a great deal of research emanating from a wide variety of disciplines, there is not a great deal of consensus about why people do, or do not, pay their taxes or otherwise comply with their tax obligations. Nonetheless, strategies to improve compliance need to be embedded in sound theory, so an understanding of the compliance literature is an important starting point for the revenue authority seeking to improve the efficiency of its collections. [12]

Models and theories of compliance behaviour tend to reflect one of three schools of thought commonly referred to as economic deterrence, social psychology, and fiscal psychology (the latter representing an evolution of the other two).

Economic deterrence models

Economic deterrence models[13] in general are based on the theory that behaviour, in a wide range of contexts including tax evasion, is responsive to punishment or sanctions. Economic deterrence models tend to have a narrow, theoretical view of behaviour, reducing its dimensions to numerical measures and assigned probabilities from which outcomes can be predicted using calculus. In order to determine behaviour in this manner, economic deterrence models tend to rely upon a wide range of fundamental assumptions that are generally unrealistic. For example, that all people respond to a change in any one variable in an identical and predictable manner; that all taxpayers have a full knowledge of the probability of being audited; and that all taxpayers have the same level of risk preference. Although empirical testing has been limited, the theoretical principles of economic deterrence have been widely adopted by tax administrations in developing enforcement strategies that rely principally on penalties and the fear of getting caught.

There is evidence to support the relevance of deterrence strategies to addressing non-compliance, but it appears that their impact may not be captured by a single mathematical expression. For example, the fear of getting caught, or the probability of detection, has been found to be an effective strategy to induce truthful reporting where the assumption that taxpayers were risk neutral was relaxed.[14] Further, in an Australian study it was found that individual tax evasion behaviour was not solely determined by the monetary value of expected gains, but that 'moral' factors also

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[12] It is noted that while most of the research has been conducted in the context of income tax, there is no reason to suggest that the theories are not equally applicable to compliance in respect of other forms of taxation. [illegible]

influenced this decision.[15] These results suggest that the economic deterrence models have relevance to compliance behaviour, but that there are other influences to be considered.

Social psychology models

Social psychology models are concerned with the prediction and understanding of human behaviour, or how people make decisions, using a range of methodological approaches including compositional modeling, attribution theory and equity theory.

Compositional modeling is characterised by the view that individuals undertake deliberate and reasoned action according to their personal preferences.[16] This approach assumes that people consider the implications of their actions before they decide, or form an intention, to engage or not engage in a given behaviour. Further, this approach assumes that intention directly translates into behaviour, without any further influences. The model then seeks to explain how intention is formed.

According to the theory of reasoned action, an individual's intention is a function of two basic determinants, one personal in nature and the other reflecting social influence. The personal factor is the individual's attitude toward the behaviour and is assumed to be either positive or negative. The second determinant of intention is the

voluntary compliance. This concept is referred to by Alm *et al*[33] as the indirect deterrent effect of audit. Alm *et al* found that ‘unofficial” communications have a strong indirect effect that increases compliance, but that “official” communications may not encourage voluntary compliance.

Smith and Kinsey developed a useful conceptual framework of tax compliance that incorporated three key points: in a complex tax system, compliance was as problematic as non-compliance; individuals have different opportunities for performing particular acts; and that tax behaviour did not necessarily involve conscious decisions.[34] It was argued that the assumption that had dominated earlier models, that non-compliance was a result of considered choices and conscious decisions by taxpayers, was neither appropriate nor needed. Some compliance may be unintentional, simply the result of indifference or habit. It was recognised that the strategies utilised to reduce intentional non-compliance may not be the most effective strategies to reduce unintentional non-compliance. This argument, viz. that compliance and non-compliance could not be understood as unitary phenomena, and therefore policy and enforcement strategies would be more effective if directed to address specific compliance behaviour, has continued to be reinforced in the literature.[35]

Clearly, understanding taxpayer compliance remains a challenging and unresolved problem. A large part of the problem appears to have been the search for one overarching model of taxpayer compliance that allowed predictions to be made about the taxpaying population as a whole. Realistically, the later typology-type fiscal psychology models offer more guidance for revenue authorities seeking to improve voluntary compliance in a dynamic environment. That is, different strategies are more appropriate for different types of taxpayers, but that an understanding of the various types of taxpayers underpins the choice of strategies. Again, this approach is consistent with the tax risk management approach advocated by the OECD and is practised today by many leading tax administrations.[36] However, as noted by Kornhauser in the context of the United States, further behavioural research is still needed and together with educational efforts aimed at all segments of the population to improve taxpayer knowledge, attitudes and behaviour, holds much promise for improving voluntary compliance.[37] These needs are not unique to the United States and could be said to be equally applicable to any tax administration, and particularly those that rely on self assessment.

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[33] Alm, J., Jackson, B. and M. McKee, 2004, ‘Audit Information Dissemination, Taxpayer Communication and Compliance: An Experimental Approach’, paper presented at 2004 IRS Research Conference, Washington D.C., June.

[34] Smith, K. and K. Kinsey, 1987, ‘Understanding Taxpaying Behaviour: A Conceptual Framework with Implications for Research’, *Law and Society Review*, 21(4), pp.639-663.

[35] See Kidder R. and C. McEwen, 1989, ‘Taxpayer Behaviour in Social Context: A Tentative Typology of Tax Compliance and Noncompliance’, in J. Roth and J. Scholz (Eds) *Taxpayer Compliance Volume 2:*

2.3 Challenges for policymakers

What emerges from the literature is that there are no quick fixes to improving taxpayer compliance. Instead, what is requi substantial additional administrative resources are doomed to failure simply because the resources are unlikely to materialise fully or in a timely fashion. Instead, more efficient alternatives (such as eliminating unproductive tasks or simplifying procedures) need to be pursued.[41] Further, Bird and Casanegra highlight the importance of a robust management information system together with the streamlining of systems and procedures in reforming tax administration.[42]

This part of the article has identified broadly and generally many of the tax compliance issues affecting taxpayers, revenue authorities and tax policymakers today. This now leads to the identification of the full range of compliance challenges that developing economies are currently facing and underpin the development of suggestions to deal with those compliance challenges.

3 STRATEGIES TO IMPROVE TAXPAYER COMPALINCE

3.1 Underlying propositions

What can be done to improve tax compliance in the context of developing economies? In the first place, there are a series of key high level and strategic propositions that must underpin the development of appropriate compliance strategies at the operational level. These propositions are summarised for convenience here.

Proposition 1: *the legitimacy and credibility of the revenue authorities need to be established and enhanced as part of a broader consensual revenue-bargaining arrangement between government and its citizens*.

This goes to the heart of good governance. Bird et al[43] conclude that a more legitimate and responsive state is likely to be an essential precondition for a more adequate level of tax effort in both developing and high income economies. This is also the key message from a number of other commentators, including Brautigam et al[44], who note that "…authority, effectiveness, accountability and responsiveness [are] closely related to the ways in which governments are financed. It matters that governments tax their citizens rather than live from oil revenues and foreign aid, and it matters how they tax them. Taxation stimulates demand for representation, and an effective revenue authority is the central pillar of state capacity."

The consensual relationship between the state and society is critical in a number of ways. "The attentions and political energies of a substantial fraction of citizens in taxation issues [are engaged] by raising taxes from them. The felt experience of paying taxes should not be confined to small numbers of companies and very rich

[41] Bird and de Jantscher, note 5, p. 6.
[42] Bird and de Jantscher, note 5, p. 9. It is noted that in developing countries tax administration *is* tax policy (Casanegra de Jantscher (1990, p. 179) cited at p. 1).
[43] Bird, R., Martinez-Vazquez, J. and B. Torgler, 2008, "Tax Effort in Developing Countries and High Income Countries" *Economic Analysis and Policy*, pp. 55-68.
[44] Brautigam, D., Fjeldstad, O-H and M. Moore (Eds), 2008, *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, Cambridge, at p. i.

people".[45] And those taxes need to be raised as consensually and as transparently as possible.

Proposition 2: *the goals and objectives of tax reform need to be clearly articulated*

short term and identify a number of conceptual and practical problems with ARAs that suggest they are not always the panacea that the World Bank may have suggested.[52]

Organisational options

Regardless of whether the revenue authority is constituted as an autonomous or semi-autonomous body, the way in which it is internally organised can have a significant impact upon the effectiveness of the tax administration. "A well-designed organizational structure can provide a foundation for effective tax administration, which minimizes tax evasion opportunities and fosters voluntary compliance".[53]

Traditionally three separate models for the organisation of revenue authorities have been suggested both in the broader organisational theory literature[54] and in more specific literature relating to tax administration:[55]

> product-based, relating to the type of tax (income tax, VAT etc) administered by the revenue authority;
>
> functional, relating to the different administrative functions performed by revenue authorities such as processing tax returns, or auditing, or collecting taxes; and
>
> client-based, relating to the different types of taxpayer according to criteria such as scale of operation (large, small etc), form of ownership or industrial/economic sector.

Sometimes, revenue agencies adopt a fourth approach, involving some combination of these three models, often referred to as a matrix approach. There are obvious advantages and disadvantages of each of the three principal approaches, as summarised in Table 1.

Developing countries have tended to move away from product-based structures built upon different types of tax to those which are based upon function, although often with elements of a client-based market segmentation approach also in evidence (for example, the introduction of large taxpayers units focusing upon the large companies which are often responsible for a disproportionate amount of revenue collections; or the introduction of industry-based organisational structures).[56] In this way they have been able to secure the advantages of improved accountability and control, enhanced compliance, better administrative efficiency, reduced corruption and more customised taxpayer service.

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[52] Fjeldstad and Moore, note 45 at pp. 249-255.

[53] Vehorn, C. and J. Brondolo, 1999, 'Organizational Options for Tax Administration', paper presented at 1999 Institute of Public Finance Conference, Zagreb, June.

[54] For example, Hodge, B., Anthony, W and L. Gales, 1996, *Organization Theory: A Strategic Approach*, Prentice Hall, New Jersey, 5th edition.

[55] Vehorn and Brondolo, note 53.

[56] Vehorn and Brondolo, note 53 at p. 21; Gallagher, note 49, at p. 133; and Fjeldstad and Moore, note 45, at p. 248.

emphasised in many countries, with the result that weak management teams and perverse management practices have been allowed to continue to the detriment of the development of a changed culture.

Nuts and bolts reform

In addition to the need for organisational change and management strengthening, there are many other more mundane, but nevertheless vital, changes that can help to create a more effective and efficient tax administration, thereby enhancing the revenue authority's capacity to enhance voluntary compliance and strengthening its ability to enforce compliance. These "nuts and bolts" reforms include strategies relating to areas such as taxpayer registration and verification.

Registration

A clean and up to date automated taxpayer registration system, involving a directory of all taxpayers in the country, along with unique identifiers (TINs), addresses and contacts details, legal residence, economic activities and links to other asset ownership such as land, vehicles and bank accounts, is an essential foundation for any compliance strategy. "The taxpayer registry is the backbone of all tax administrations",[59] and should have easy and automatic links to the rest of the tax administration's systems. It is the basis upon which the tax administration communicates with the taxpayer and advisers, maintains tax filing and tax payment records, and it also feeds naturally into the verification and risk profiling processes discussed later.

An efficient registration system also allows automated default systems to leverage off the central system. This may involve the automatic detection of "stop filers", non-filers and taxpayers who have not paid the full taxes shown as due in their tax returns.[60] For example, Gallagher notes that in many developing economies, seemingly unexplainable drops in fiscal revenues have resulted solely due to the fact that taxpayers have found that they can simply stop filing their VAT declarations with impunity. He therefore suggests that tax administrations should have automated notification and follow-up systems that immediately remind taxpayers of their responsibility to file and pay their tax obligations.[61]

Many developing economies (and most developed) have introduced unique Taxpayer Identification Numbers ("TINs") as a means of ensuring registration by taxpaying units (whether individuals or corporates). This is a strategy facilitated by the development and spread of digitalisation and communication technologies.[62] The existence of a TIN "forms the basic building block for revenue administration IT systems, as it allows connecting taxpayers to their returns, payments and major taxable transactions with third parties".[63] Field surveys to detect unregistered taxpayers, as well as extensive publicity campaigns, have often accompanied the introduction of TINs.

[59] Gallagher, note 49, p. 139.
[60] Gill, note 48, p. 16.
[61] Gallagher, note 49, p. 137.
[62]

Verification

The verification process involves data gathering, analysis and matching, together with appropriate risk analysis and profiling, in order to establish which taxpayers are likely to be the greatest compliance risks, and where scarce resources should therefore be concentrated in the audit and investigation phase.

Verification activities need to vary according to the type of taxpayer and level of risk involved. Data collection, or intelligence gathering, should be from as wide a range of relevant sources as possible, including internal sources (central registry, tax returns, information about other taxes etc) and external or third party sources (such as financial institutions, government agencies, trade associations, other businesses and information from other taxpayers). Data analysis needs to be undertaken on an ongoing basis to inform and refine the understanding of the taxpayer base and the types of compliance behaviour exhibited.

One of the key aspects in ensuring compliance is the need to build and analyse risk

The consequences of corruption are obvious. It is a cancer that destroys the organisation itself and undermines all other aspects of society. It erodes confidence in the tax system and encourages evasion. It increases the costs of doing business and distorts the level playing field that should be

Reduce compliance costs

Compliance costs for taxpayers in developing countries are four to five times higher than those in developed countries.[77] This therefore suggests that reducing compliance costs "lowers the amount of bribe a (rational) taxpayer might be willing to pay to avoid the declaration and payment process".[78]

One strategy that does not appear to have been successful in combating corruption is the privatisation or outsourcing of the tax collection function. Tax farming (the process where the right to collect tax is auctioned off to a private agent in exchange for a fixed sum payable in advance) and tax sharing (whereby private agents collect taxes, with the right to keep a share of the total collection) have often been introduced with the objective of reducing administrative costs and increasing the level and reliability of collections.[79] The examples of outsourcing of some local authority tax collection in Tanzania and Uganda suggest that they may sometimes have succeeded in increasing revenue collections, but that the levels of corruption have also increased.[80]

3.2.2 Fostering voluntary compliance

In 2004 the OECD suggested that "[c]ompliance is most likely to be optimised when a revenue authority pursues a citizen-inclusive approach to compliance through policies that encourage dialogue and persuasion, combined with an effective mix of incentives and sanctions".[81] This section of the article focuses upon the voluntary aspects of this broad compliance strategy, while Section 3.2.3 turns to the sanction-based enforced elements.

Gill notes that voluntary tax compliance does not have a long history in many developing economies.[82] Nonetheless, this has been an area where significant developments have taken place in recent years. There has been a "very substantial shift in the attitudes of tax administrations towards taxpayers".[83] Based in large part on the literature on compliance explored in Section 2 of this article, tax administrations have come to recognise that that a cooperative and positive engagement with taxpayers and their advisers in a customer-service focused and user-friendly environment will be more productive and efficient than more traditional adversarial and antagonistic approaches.

[77] Evans, C., 2003, "Studying the Studies: An Overview of Recent Research into Taxation Operating Costs", *eJournal of Tax Research*, Vol. 1 No. 1, pp. 64-92.
[78] Bahl and Bird, note 3, p. 291.
[79] Joshi, A and J. Ayee, 2008, 'Associational Taxation: A Pathway into the Informal Sector', in Brautigam, D., Fjeldstad, O-H and M. Moore (Eds) *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, Cambridge, pp. 183-211, p. 190.
[80] Bahiigwa, G., Ellis, F., Fjeldstad, O-H. and V. Iversen, 2004, 'Uganda Rural Taxation Study', Report commissioned by DFID Uganda, Economic Policy Research Centre, Kampala; and Kobb, D. 2001, 'Corruption in Tanzania: An Application of Tax Farming' Mimeo, Tanga Tanzania and KKonsult USA.
[81] OECD, 2004, note 8, p. 48.
[82]

Research consistently shows that the burden of tax compliance is significant and that it falls more heavily on small businesses than on large businesses (compliance costs are regressive).[88] This has prompted authorities to increase efforts to simplify compliance requirements, including exploring ways of more closely aligning tax reporting to the natural systems businesses use for their own banking, accounting and financial reporting. Such initiatives ha

providing the opportunity for reduced annual filing for those taxpayers where the revenue authority is already aware of all income and has already received all relevant tax through withholding or related measures;[95]

using pre-population and pre-filling techniques with returns and other forms to avoid the necessity for taxpayers to provide information that the revenue authority already possesses;[96]

3.2.3 Strengthening and enforcing compliance

The overall strategy of a revenue authority should always be to encourage voluntary compliance wherever possible, and to fac courts and appeals systems, and law enforcement expertise and ability to liaise with other governmental offices.[98] This appears to be a better idea than the introduction of a separate "Tax Police" – introduced in some Eastern European and South American regimes – which has a sub-optimal effect as it artificially splits tax law enforcement between two organisations.[99])

The essential point of these escalating levels of sanctions is "to heighten the risk perception and demonstrate the revenue administration's capacity to detect and punish evasion".[100] Gill goes on to note that this "is perhaps still the weakest area in revenue administrations in most developing countries".[101] It is therefore an area that deserves closer attention, by reference to specific secondly, an approach based upon risk analysis allows the revenue administration to be more selective in scrutinising cases, resulting in more intense scrutiny and better use of scarce audit and investigation resources; and

finally, the fact that most cases are not investigated means less interaction between tax officials and the taxpayers – resulting in lower compliance costs and less opportunity for corruption.

Sanctions

Any revenue authority needs to have appropriate powers to enforce compliance, including a full range of penalties (monetary and imprisonment) that can be applied where taxpayers have not properly complied. Often the threat of punishment can be as effective a sanction as the punishment itself. In its 2004 study, the OECD notes that while the revenue authority's preferre34019 Tce .8(i)eg,i73efgt whi400006 TcwJ/petter elf-regul (*deterrence*) and they support the perception among the compliant that their compliance is not in vain: wrongdoers are being pursued (*reinforcement*); and

exercising vigilance in follow-through of known defaults in relation to basic obligations of registration, filing, reporting and payment. At some point, leniency in extending time to pay becomes counterproductive in promoting voluntary compliance.[110]

3.2.4 Tackling the shadow economy

The assumption thus far is that the taxpayers are within the tax system or are otherwise known to the tax authorities. This section considers the case of those not in the system – members of the shadow or cash or informal economy, often referred to as part of the "hard to tax".

It has already been noted that the informal sector is likely to be large in most developing countries. It is also "complex and heterogeneous. It comprises large and small enterprises, urban and rural firms, owners as well as workers, and local activities as well as those that cross jurisdictional boundaries".[111]

Revenue authorities, in both developed and developing economies, are often tempted to give the informal sector low priority – it is, by definition hard to tax and, in terms of productivity, returns on effort may not be spectacular. Moreover, employees of revenue authorities in developing economies will tend to want to avoid the sector because it is likely to be "unrewarding in terms of income supplementation" and because working in that sector is likely to be "unpleasant, difficult or even dangerous".[112] There is simply no incentive for employees to get involved.[113] Even tax consultants and scholars, advising those in developing economies, have often considered seeking to tax the informal sector as too difficult, requiring considerable effort with few returns.[114] It is not surprising that they have tended to concentrate on the easier pickings from the "low hanging fruit", by focusing on the introduction of VATs, tax system simplification and reform of tax administration.

Nonetheless there are good public policy and other reasons for tackling the informal sector. Businesses that fail to meet their tax obligations pose a threat to those that do in the form of unfair price competition.[115] The playing field is therefore not level, and such unfairness causes legitimate businesses to consider exiting the system in order to counter the threat. A thriving cash economy reduces revenue collections and undermines the community's confidence in the tax system. Moreover, it is in the interests of the governments of developing economies to have as broad a tax base as

[110] OECD, 2004, note 8, pp. 50-51.
[111] Joshi, A and J. Ayee, 2008, 'Associational Taxation: A Pathway into the Informal Sector', in Brautigam, D., Fjeldstad, O-H and M. Moore (Eds) *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, Cambridge, pp. 183-211, p. 184.
[112] Fjeldstad and Moore, note 45, p. 244.
[113] Joshi and Ayee, note 111, p. 190.
[114] Joshi and Ayee, note 111, p. 185.
[115] OECD, 2004, note 8, p. 55.

possible, and to protect that revenue base. And spreading the tax net also contributes to the state-building capacity and the legitimacy of developing economies.[116]

Successful strategies to tackle the informal sector are therefore more difficult to find, but are typically built around the same essential risk analysis framework that more conventional voluntary and enforced compliance strategies follow. Thus revenue authorities focus on particular sectors or groups that are perceived to constitute more serious risks to revenue. For example, tax authorities in developed economies consider, as high risk, sectors where cash

therefore increasingly concerned with developing appropriate compliance monitoring frameworks. As the OECD notes[122], revenue bodies "require a comprehensive and robust set of outcome-related measures and indicators reflecting the results of their programs and strategies to achieve improved compliance with the tax laws". A compliance monitoring framework is broadly defined as "an agency-wide strategy for monitoring compliance and evaluating the impacts of specific compliance improvement activities. To achieve its objectives, it embraces a comprehensive range of compliance measures and indicators and accompanying measurement methodologies for the key compliance obligations of the major taxes administered by the revenue body".[123]

Such monitoring frameworks, the OECD suggests, should therefore:

encompass the major taxes administered at the aggregate level;

explicitly report on the main compliance risk types;

report on compliance impacts at the program and targeted risk level; and

include a comprehensive set of measures and indicators, all of which have a multi-year focus (three to five years).

4. CONCLUSIONS

Effective tax reform designed to enhance tax compliance outcomes requires commitment by government and time. It is not a process to be rushed and caution is counseled, particularly in respect of getting the right balance of policy objectives.[124] Legitimacy and credible commitment has to be established by government and the revenue authority if taxpayers are to comply voluntarily and this political capacity can in turn impact on the extractive capacity (i.e. revenue collections) of government.[125] This commitment needs to be at all levels of government and public offices including the judiciary.[126] There is a need to ensure that commitment at all levels of government continues to build and this could be helped by co-ordination and the promotion of fiscal responsibility at sub-national levels and the implementation of a stable and transparent system of transfers.[127]

[122] National Audit Office, 2008, "Comparing How Some Tax Authorities Tackle the Hidden Economy", NAO, London, April; OECD, 2008, *Monitoring Taxpayers' Compliance: A Practical Guide Based on Revenue Body Experience,* OECD, Paris available at http://www.oecd.org/dataoecd/51/13/40947920.pdf accessed 18 August 2008 at p. 27.

[123] OECD, 2008, note 122 at p.22.

[124] Bird (1983) cited in Fjeldstad, O. and L. Rakner, 2003, "Taxation and Tax Reforms in Developing Countries: Illustrations from Sub-Saharan Africa", Chr Michelsen Institute *Development Studies and Human Rights* R2003:6 at p.28.

[125] Fauvelle-Aymar, C., 1999, "The PoliticalJ-30.1ly

The key lesson that this article has attempted to convey is that there is no single appropriate tax compliance strategy for any developing or transitional country that can be plucked off the shelf and implemented. Each country is unique. But there is a vast body of research and practical experience, culled from both developed and developing economies, which can help to inform and shape the compliance program that can work for developing countries. In order to manage and improve tax compliance, revenue authorities need to adopt an approach that encourages voluntary compliance within a co-operative and participative regulatory environment. Moreover, in choosing and applying appropriate risk-based treatment strategies, such countries would do well to heed the advice of the OECD that:[128]

> compliance programmes need to provide a graduated response to compliance behaviour — making it easy for those who want to comply and applying credible enforcement to those who do not;
>
> treatment needs to address the underlying drivers of compliance behaviour;
>
> the most effective strategies are likely to be multi-faceted and systemic;
>
> the first step is often to ensure that taxpayers understand their taxation obligations and find it easy to comply;
>
> acting at all times with integrity and in a manner perceived to be fair and reasonable will encourage voluntary compliance;
>
> enhanced capacity to influence taxpayer compliance behaviour often comes through strategic alliances and partnerships with other agencies, industry bodies and tax advisers;
>
> strategies need to be applied in a way that demonstrates effective and efficient use of resources;
>
> sustainable improvement in compliance can only be achieved by influencing and changing social and personal norms.

[128] OECD, 2004, note 8, pp. 71-72.